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FM AMEMBASSY CAIRO  
TO RUEHC/SECSTATE WASHDC PRIORITY 8265  
INFO RUEHXK/ARAB ISRAELI COLLECTIVE PRIORITY  
RUEHBJ/AMEMBASSY BEIJING PRIORITY 0192  
RUCPDOC/DEPT OF COMMERCE WASHDC PRIORITY

UNCLAS SECTION 01 OF 02 CAIRO 000361

SIPDIS

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STATE FOR NEA/ELA, EEB/TPP/BTA/ANA/SAGURTON  
USTR FOR MOWREY  
COMMERCE FOR 4520/ITA/ANESA

E.O. 12958: N/A

TAGS: ECON ETRD PREL KTEX IS EG

SUBJECT: QIZ EXPORT DROP REINFORCES EGYPTIAN-ISRAELI  
EXPANSION REQUEST

CAIRO 00000361 001.2 OF 002

ZFR ZFR ZFR ZFR ZFR

KINDLY ZFR CAIRO 361.

CABLE WILL BE RETRANSMITTED UNDER NEW NUMBERS.

CAIRO 00000361 002 OF 002

Trade and Labor Eliyahu Yishai agreed on Oct. 9, 2007, to reduce the required level of Israeli content to 10.5 percent (ref B) and to request that USTR expand the QIZ area to Upper Egypt (ref C). While both moves work in favor of the GOE, Israeli negotiators said they viewed the expansion of markets into Upper Egypt as a benefit to offset their reduced export income due to the content reduction agreement (ref D).

¶8. (U) The GOE argues in a brief on the expansion proposal (which we submitted separately to the Department and USTR) that QIZ expansion would not have an immediate or dramatic effect on QIZ exports to the United States. The eight governorates of Upper Egypt are underdeveloped, accounting for only 13 percent of investment in Egypt while representing 27 percent of the population. According to GOE figures, Upper Egypt has a higher rate of poverty -- 34 percent, compared to 20 percent -- and a higher rate of illiteracy -- 43 percent, compared to 34 percent -- than the rest of Egypt.

¶9. (U) While the lack of existing infrastructure and industrial capacity would prevent rapid growth of QIZ exports from Upper Egypt, the GOE and Egyptian industrialists hope that access to a relatively untapped labor market and abundant land would allow for QIZ expansion, easing the pressure on capital and labor expenses in existing factories.

The GOE has provided land grants and financial incentives to developers in the region in keeping with President Mubarak's pledges to rectify underdevelopment there.

¶10. (U) The GOE expects industrial development in Upper Egypt could lead to higher employment, higher standards of living, and reduced migration to Cairo and other urban centers in Egypt. The GOE argues that expanding the program would expand its political benefits, demonstrating to another region of the country the value of Egyptian-Israeli cooperation, while continued underdevelopment would breed instability and extremism.

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COMMENT  
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¶11. (SBU) QIZ workers we meet have little or no appreciation of the political dynamics of the agreement. But they do know that QIZ means jobs, and thousands of them took to the streets to demand inclusion in the agreement at its onset. The GOE understands that logic, believing that expanding the QIZ into Upper Egypt will ultimately mean expanding employment. As a result, it has worked closely with the GOI to develop this request. The political benefit of improving Israeli-Egyptian relations will be long-term through the development of enduring business ties.

¶12. (SBU) QIZ expansion into Upper Egypt will not significantly broaden the base of QIZ exports beyond textiles. While some Egyptian food processors are considering QIZ development in Upper Egypt, we expect that the economics of the arrangement will continue to overwhelmingly favor exporters of ready-made garments. Only products that normally face high tariffs in the United States benefit enough from the QIZ duty-free status to compensate for the extra expense of the Israeli inputs.

¶13. (SBU) However, that supports the GOE contention that QIZ expansion would not affect any domestic US industry; Egypt would continue to compete with China and other textile exporters for market share in the United States. Considering the economic constraints on QIZ exporters, as well as the business environment in Upper Egypt, it is unlikely that the region would account for more than single-digit increases in QIZ exports. QIZ expansion would, however, help move the US-Egyptian economic partnership from aid to trade at a time of declining ESF assistance. It would also strengthen key reformers in the cabinet -- notably Prime Minister Nazif and Trade Minister Rachid -- and strengthen official GOE-GOI relations when other regional dynamics are stressing them.

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